Report

of the

Examination of

Family Health Plan Cooperative

Milwaukee, Wisconsin

As of December 31, 1997

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August 14, 1998

Honorable Randy Blumer
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

FAMILY HEALTH PLAN COOPERATIVE
Milwaukee, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Family Health Plan Cooperative (FHPC or the cooperative) was conducted in 1995 as of December 31, 1994. The current examination covered the intervening period ending December 31, 1997, and included a review of such 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the cooperative's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Provider Contracts
Territory and Plan of Operations
Affiliated Companies
Growth of the Cooperative
Reinsurance
Financial Statements
Accounts and Records
Data Processing
Enrollee Complaint Procedure
Underwriting

Emphasis was placed on the audit of those areas of the cooperative's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the cooperative to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the cooperative's operations is contained in the examination work papers.

The cooperative is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

Family Health Plan Cooperative can be described as a nonprofit, staff model health maintenance organization (HMO) insurer. An HMO insurer is defined by s. 609.01 (2), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that makes available to its enrolled participants, in consideration for predetermined fixed payments, comprehensive health care services performed by providers selected by the organization." Under the staff model, the HMO has a group of physicians on staff who are paid a specific salary. The HMO contracts for specialty care services. HMOs compete with traditional fee-for-service health care delivery.

Family Health Plan Cooperative was incorporated March 20, 1978, under the provisions of s. 185.985, Wis. Stat., and commenced business February 28, 1979.

Family Health Plan owns and operates seven health centers for the provision of health care to its members. The services given at the clinics include, but are not limited to, primary care, prescription drugs, optometry, lab, and x-ray services.

The medical staff of Family Health Plan includes the following various primary care professionals:

Primary Care Physicians	74
Physician Assistants	76
Obstetricians/Gynecologists	5
Pediatricians	3
Radiologists	6
Surgeons	4

The cooperative also has mental health providers, chiropractors, dietitians, and optometrists on staff to provide the related specialty care without a referral from the member's primary care physician. For other specialty services, the member is required to obtain a written referral from their primary care physician.

The staff physician employment contract generally calls for a minimum of 36 scheduled clinic hours per week in addition to any necessary hospital rounds and a full share of emergency calls as assigned by the medical director. Staff physicians receive an annual salary from the cooperative for their services. The contracts include hold-harmless provisions for the protection of policyholders.

For specialty care services, Family Health Plan contracts with over 145 provider groups. The specialists under these contracts are required to be available to Family Health Plan members during specified hours during the day. Members must obtain a written referral from their primary care physician for the specialty service to be covered. The specialty provider contracts include hold-harmless provisions for the protection of policyholders. Generally, the contracts have a one-year term and automatically renew unless either party gives the other 90 days' written notice prior to the end of the contract year.

The cooperative has four contracts for the provision of inpatient and outpatient services, covering eight hospitals. Hospitals are reimbursed on a negotiated per diem, discounted fee-for-service, or capitation basis. The hospital contracts include hold-harmless provisions for the protection of policyholders.

The following is a listing of hospitals that contract with Family Health Plan:

Covenant Healthcare System
- St. Francis Hospital
- St. Michael Hospital
- St. Joseph's Hospital
- Elmbrook Memorial Hospital

Waukesha Hospital Systems
- Waukesha Memorial Hospital
- Oconomowoc Memorial Hospital

Children's Hospital of Wisconsin
Froedtert Memorial Lutheran Hospital

The cooperative's service area is comprised of the following counties: Milwaukee, Waukesha, Washington, Ozaukee, Racine, and Walworth.

The cooperative offers comprehensive health care coverage under numerous policies, many of which include copayment provisions. The following basic health care coverages are provided:

Physician services
Inpatient services
Outpatient services
Mental health, drug, and alcohol abuse services
Ambulance services
Special dental procedures (oral surgery)
Prosthetic devices and durable medical equipment
Newborn services
Home health care
Preventive health services
Family planning

Hearing exams
Routine eye examinations
Convalescent nursing home service
Prescription drugs
Cardiac rehabilitation, physical, speech, and/or occupational therapy
Health education
Diabetes education and supplies
Kidney disease treatment
Certain transplants
Chiropractic services
Hospice care

Skilled nursing care is limited to 30 days. In recent years, inpatient mental health under Family's policies has been limited to 60 days per contract year with no single hospitalization to exceed 30 days. Generally, inpatient AODA coverage has been limited to 30 days and $2,700.00 per contract year; outpatient AODA coverage, to $1,800.00 per year. FHPC is currently revising its coverage, consistent with the federal Mental Health Parity Act and state law. Plan coverage is contingent on nonemergency services being provided by participating physicians and hospitals or on the referral of participating physicians. Members are required to choose a primary care physician from the listing of staff physicians available.

The cooperative also offers various copayment plans in which the members are required to pay a copayment on certain services. Under certain plans, FHPC utilizes a drug formulary and charges the member a copayment for prescriptions not on the preferred formulary.

In June 1996, a joint venture alliance (JVA) was formed among Family Health Plan Cooperative, Family Health Systems, Wheaton Franciscan Services, Inc. (WFSI), Wheaton Health Network (WHN), Covenant Healthcare System, Inc. (CHS), and Network Health Plan of Wisconsin (NHP). (The latter three of these entities are affiliates of WFSI.) The stated purpose of the JVA was to create a new "triple option" product, underwritten by NHP, that would encompass a staff model HMO, a network model HMO, and a point-of-service program. Under the JVA, the entities agreed to explore the feasibility of integrating various functions of management and health care delivery systems. The joint venture alliance markets its products under the name Community Health Plan. Under the agreement, Family Health Systems serves as the primary administrator of the business. The following agreements were either created or amended in conjunction with the JVA:

- Health care services agreement for Covenant to act as a provider for FHPC
- Participating provider agreement, under which FHPC makes its physicians available to WHN
- Administrative services agreement for FHS to provide services to WHN
- Administrative services agreement for WHN to provide services to NHP
- Management agreement for FHS to provide administrative services to FHPC

The cooperative currently markets to groups only. The cooperative uses both internal sales staff and outside agencies. The standard agent/broker commission schedule is as follows:

Group Size	Commission Rate
1-25	8.0%
26-49	6.0
50-99	3.0
100-249	2.0
250-499	1.5
500-999	1.0
1,000+	0.5

In addition, agents can earn a volume production bonus based on monthly premium volume.

The cooperative uses an actuarially determined base as a beginning point in premium determination. This rate is adjusted to reflect the age, sex, and coverage characteristics for a group and allowance is made for administrative loading. Experience trends are reviewed for renewal groups and factored into adjusting the rate. The cooperative is currently having a consultant perform an actuarial review of its pricing models and underwriting procedures used, prior to development of its comprehensive pricing policy for the 1998/99 period.

The cooperative has developed procedures to monitor the actions of its primary care physicians. Peer review, physician credentialing, quality assurance, and utilization review activities occur within the framework of the annual quality improvement program and work plan, under the oversight of the medical director and quality improvement steering committee. As another control feature, all elective out-of-plan referral procedures must be preauthorized by the cooperative's medical director.

FHPC's grievance policy defines a grievance as any member disagreement with any action taken by Family Health Plan, including administration, claims practices or provision of services, which is expressed in writing. FHPC utilizes a membership advisor to "act as an interface with members" and coordinate the complaint/grievance process. The services of the membership advisor are described as being preliminary to the grievance procedure—if a membership advisor cannot satisfactorily resolve a member complaint within 5 days of such being filed, the membership advisor is to inform the member of the formal grievance procedures. Three levels of review are available for a member grievance. An initial written grievance is filed with the member services supervisor, for review by the benefits review committee. Company policy calls for all grievances to be acknowledged within 10 days of receipt and generally resolved within 30 days. If a member is dissatisfied with the determination of the benefits review committee, a written appeal may be made to the executive director. If a member remains dissatisfied, a written request may be made for a third and final level of review from the health services committee. In urgent care situations, FHPC policy calls for grievances to be resolved within 4 days of the date the grievance is received.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of 17 members, plus two emeritus directors. Directors are divided into three classes with staggered terms of office; three years is the longest term of office. Officers are appointed by the board of directors. The board members currently receive an annual retainer of $3,350 ($3,950 for the chair) for serving on the board, and per-meeting fees of $600/full board meeting and $300/committee meeting. Emeritus members receive $600 quarterly, plus $600/board meeting.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Stanton Bluestone Whitefish Bay, WI	Chairman & CEO Carson Pirie Scott	2000
Eric Christianson, MD Greendale, WI	Chief—Primary Care, Airport FHPC	2000
Rick Cogswell Milwaukee, WI	Managing Director GS^2 Securities Inc.	1999
Jaime E. Davila Milwaukee, WI	Pastor Evangelical Baptist Church	Emeritus
Vivien DeBack, PhD, RN Franklin, WI	Nurse consultant Empowering Change	1999
Carol J. Erwin Elm Grove, WI	Principal Erwin Public Relations	2001
James W. Grebe Franklin, WI	President Grebe's Bakery	2000
Jack M. Kaczkowski New Berlin, WI	District representative Lutheran Brotherhood	2001
Russell J. Kafka Milwaukee, WI	Vice President—Investments Catholic Knights Insurance Society	1999
Joe Kiriaki Racine, WI	International representative UAW, Region 4	1999
Thomas N. Lesch Oak Creek, WI	Director, International Assoc. of Machinists & Aerospace Workers	2000
David W. Lillich, MD Whitefish Bay, WI	Associate professor Medical College of Wisconsin	2000
Ronald M. McClaron Brookfield, WI	Director—Corporate Relations Miller Brewing Co.	2000

David C. Olson, MD Wauwatosa, WI	Chief—Primary Care, Bluemound FHPC	1999
John Parr Milwaukee, WI	Consultant John Parr Associates	2000
Carlos M. Soto, EdD Mequon, WI	Dean—Health Occupations Milwaukee Area Technical College	2001
Tamra Stark Milwaukee, WI	Executive director Community Health Concepts	1999
Lawrence J. Wahl Cudahy, WI	Retired Vice President United Electrical, Radio & Machine Workers of America, District 11	2000
Wilbert L. Walter West Allis, WI	Retired director of community services Wisconsin State AFL-CIO	Emeritus

Officers of the Company

The officers elected or appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	1998 Salary
Tamra Stark	President (Chair)	*
Thomas N. Lesch	Secretary	*
John Parr	Vice President	*
Russell J. Kafka	Treasurer	*

* - Compensation as noted above in the section captioned, "Board of Directors."

Committees of the Board

The cooperative's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Tamra Stark, Chair
Carol Erwin
Jack Kaczkowski
Russ Kafka
Thomas Lesch
John Parr
Lawrence Wahl

Health Services Committee
Vivien DeBack, Chair
Carol Erwin
Jack Kaczkowski
Joe Kiriaki
Thomas Lesch
John Parr
Carlos Soto
Tamra Stark
Lawrence Wahl
David Lillich, MD
David Olson, MD
Eric Christianson, MD

FHPC/FHS Relations Committee	**Nominations Committee**
John Parr, Chair	Jack Kaczkowski, Chair
Jack Kaczkowski	Vivien DeBack
Russ Kafka	Carol Erwin
Thomas Lesch	Joe Kiriaki
Tamra Stark	Thomas Lesch
Joe Kiriaki	John Parr
	Tamra Stark
	Lawrence Wahl

In addition to the above, there is also a joint venture steering committee, which coordinates activity pertaining to the Community Health Plan business. Membership of the committee consists of representatives of FHPC, Family Health Systems, and Wheaton Franciscan Services:

Joint Venture Steering Committee ("★" indicates FHPC representatives)

Michael Hammes, Chair	A. Bela Maroti
Vivien DeBack★	John Oliverio
Robert Dude	John Parr★
Mark Knight	Thomas Sheahan
Thomas Lesch★	Tamra Stark★

Through 1997, the full board and the executive committee met in alternating months. Effective in 1998, FHPC's committees were restructured. Under this restructuring, several committees were discontinued, the executive committee was inactivated, and the board was scheduled for monthly meetings to handle a broader array of issues.

The cooperative employs its own physicians and health center staff. Necessary management and administrative staff are provided through a management agreement with its affiliate, Family Health Systems. Under the agreement, effective June 25, 1996, through July 31, 2007, FHS assumes responsibility for the competent and efficient management of the operations of the cooperative's health delivery system including, but not limited to, administrative, operational, financial, medical management, marketing, and public affairs matters. In addition, the agreement states that FHS shall have the responsibility for performing such other tasks as may be necessary to carry out the policies established by the cooperative's board of directors. The agreement may be terminated: by mutual written agreement of the parties; for cause, with 30 days' written notice; due to the liquidation or insolvency of either party; or by the Commissioner of Insurance in order to protect the interests of the cooperative's members. Family Health Systems' compensation for services rendered is based on a fixed capitation per member per month. Beginning in 1998, a “blended” base capitation rate is to be calculated and used for both the FHPC contract and a similar agreement with Wheaton Health Network. The management fee includes provision for withholding 10% of the fee, which may be earned back on the basis of achieving specified annual performance standards. For 1997, FHS earned back approximately 3% (or about 30% of the total withheld). In its annual performance review, passing grades were received regarding goals in the areas of member satisfaction, quality of service delivery, information systems, coordination-of-benefits recoveries, and company relations. Goals not met were in the areas of membership growth and affordability, among others.

Members of the management team provided through the management agreement with Family Health Systems, Inc., are as follows:

Name	**Office**	**1998 Salary**
David Bradford	President/CEO	$165,000
Abram McCabe	VP Marketing	93,500
Mark Corcoran	VP Finance/CFO	130,000
Lowell Keppel	Associate Medical Director	176,610
Suzette Magruder	VP Health Care Operations	112,000

Financial Requirements

The financial requirements for an HMO under s. Ins 3.50, Wis. Adm. Code, are as follows:

		Amount Required
1.	Minimum capital or permanent surplus	Either: $750,000, if organized on or after July 1, 1989 or $200,000, if organized prior to July 1, 1989
2.	Compulsory surplus	The greater of $750,000 or: If the percentage of covered liabilities to total liabilities is less than 90%, 6% of the premium earned in the previous 12 months; If the percentage of covered liabilities to total liabilities is at least 90%, 3% of the premium earned in the previous 12 months
3.	Security surplus	The greater of: 140% of compulsory surplus reduced by 1% of compulsory surplus for each $33 million of additional premiums earned in excess of $10 million or 110% of compulsory surplus
4.	Operating funds	Funds sufficient to finance any operating deficits in the business and to prevent impairment of the insurer's initial capital or permanent surplus or its compulsory surplus

Covered liabilities are those due to providers who are subject to statutory hold-harmless provisions.

In addition, there is a special deposit requirement equal to the lesser of the following:

1. An amount necessary to maintain a deposit equaling 1% of premium written in this state in the preceding calendar year;

2. One-third of 1% of premium written in this state in the preceding calendar year.

The cooperative has satisfied this requirement for 1997 with a deposit of $1,750,000 with the State Treasurer.

Insolvency Protection for Policyholders

Under s. Ins 3.50, Wis. Adm. Code, HMOs are required to provide continuation of coverage for its enrollees. These requirements are the following:

1. Enrollees hospitalized on the date of insolvency will be covered until discharged; and

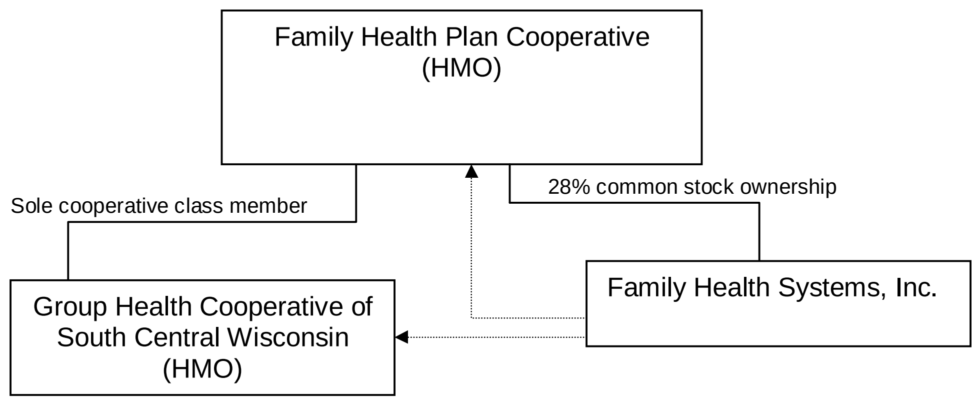
2. Enrollees will be entitled to similar, alternate coverage which does not contain any medical underwriting or preexisting limitation requirements.

The cooperative has met this requirement through its reinsurance contract, as discussed in the "Reinsurance" section of this report.

IV. AFFILIATED COMPANIES

The organizational chart below depicts the relationships among the cooperative and its affiliated entities. A brief description of the significant affiliates follows the organizational chart.

Affiliated Companies Chart
As of December 31, 1997



Note: The dotted line refers to the provision of management and administration services.

Family Health Systems, Inc. (FHS)

FHS is a for-profit, Wisconsin stock company incorporated in February 1987. FHS provides administrative, marketing, planning, and management services to HMOs. The management agreement between FHS and FHPC is described in the "Management and Control" section of this report. FHS has ownership interests in the following entities: Wheaton Health Network, Family Health Systems of Indiana, Family Health Plan of Indiana, SGM Management, Inc./Surgicenter of Greater Milwaukee, and Home Health Technologies, Inc. For the fiscal year ended March 31, 1998, the consolidated audited financial statements of FHS reported assets of $32,444,871, liabilities of $7,778,145, and shareholders' equity of $24,666,726. Net income for the year ended March 31, 1998, was $1,312,068 on revenues of $43,151,001.

Group Health Care Cooperative of South Central Wisconsin (GHC)

GHC is a nonprofit, staff model HMO, organized under ch. 185, Wis. Stat. FHPC is the sole cooperative class member/controlling member of GHC. Under the consolidation agreement, signed in 1988, it was agreed that management of GHC would be through a management agreement with Family Health Systems, Inc. As of December 31, 1997, the HMO's filed annual statement reported assets of $33,132,306, liabilities of $13,216,845, and capital and surplus of $19,915,461. For the year ended December 31, 1997, the company had net income of $1,364,392 on revenues of $68,308,547.

V. REINSURANCE AND CORPORATE INSURANCE

The cooperative has reinsurance coverage under the contract outlined below:

Reinsurer:	Lincoln National Health and Casualty Insurance Company
Type:	Specific Excess of Loss Reinsurance
Effective date:	February 1, 1997 Initial agreement year: 2/1/97 – 12/31/97. Subsequent agreement years shall begin on January 1 and end on the following December 31.
Retention:	$125,000 per member per agreement year
Coverage limits:	Eligible hospital services are limited to an average of $3,000 per day, excluding operating room and post-operative charges, physician and surgeon charges. There is also a $2,000,000 lifetime maximum per member.
Coverages:	Eligible hospital services in excess of deductible are indemnified as follows:

Member in excess of one year of age:	
Per diem or approved fixed procedural fee hospital	90%
Other hospital	80
Member under one year of age:	
Per diem or approved fixed procedural fee hospital	90%
Other hospital	70
Organ or bone marrow transplant therapy:	
Per diem or approved fixed procedural fee hospital	80%
Other hospital	50

Premium:	$0.35 per member per month
Termination:	Agreement shall continue in effect from effective date until terminated. Agreement may be terminated in the following circumstances: (1) Automatically if premiums are not paid; (2) Upon the insolvency of either the reinsurer or the cooperative; (3) By reinsurer, with 31 days' written notice, in the event of a material change, as defined in the agreement; (4) By either party, with 31 days' written notice prior to the end of an agreement year.

The reinsurance policy has an endorsement containing the following insolvency provisions:

1. Lincoln National will continue plan benefits for members who are confined in an acute-care hospital or skilled nursing facility on the date of insolvency until their discharge.

2. Lincoln National will continue plan benefits for any member insured until the end of the contract period for which premiums have been paid to plan by that member or on his behalf.

3. Lincoln National will make available to all members for a period of 31 days, without evidence of insurability, a replacement coverage of the same benefit schedule and rates as then being offered by Lincoln National to other prospective insureds within the state.

In addition, the cooperative is provided with corporate insurance coverage under the contracts listed below:

Type of Coverage	Policy Limits
Commercial Insurance Package	
Property:	
Building and contents (replacement cost)	$34,850,100
Electronic data/work processing (replacement cost)	1,765,900
Boiler and machinery/air conditioning)	5,000,000
Business income (per incident)	5,600,000
Liability:	
General aggregate	2,000,000
Products/completed operations aggregate	1,000,000
Personal/advertising injury	1,000,000
Each occurrence	1,000,000
Fire damage (any 1 fire)	100,000
Medical expense (any 1 person)	5,000
Auto liability	1,000,000
Worker's compensation	500,000
Commercial umbrella	15,000,000
Crime (fidelity):	
Employe dishonesty blanket	1,000,000
Forgery or alteration	100,000
Professional Insurance Package	
Not-for-profit liability	5,000,000
Medical professional liability:	
Annual aggregate	3,000,000
Each occurrence	1,000,000
Managed health care professional liability	5,000,000
Fiduciary bond	10,000,000

The above coverages were obtained through various insurers which are licensed in Wisconsin or on the Commissioner's current list of approved surplus lines insurers.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the cooperative as reported in the December 31, 1997, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Net Worth per Examination." Also included in this section are schedules that reflect the growth of the cooperative for the period under examination.

Family Health Plan Cooperative
Assets
As of December 31, 1997

Current Assets:			
Cash and short-term investments		$ 2,864,652	
Premiums receivable--net		12,928,293	
Interest income receivable		191,670	
Health care receivables		2,685,740	
Reinsurance recoverable on paid losses		1,091,911	
Aggregate write-ins for other current assets			
(1) Pharmacy supplies inventory	1,192,732		
(2) Prepaid Expenses	1,564,883	2,757,615	
Total current assets			$22,519,881
Other Assets:			
Restricted cash and other assets		2,239,655	
Bonds		4,177,132	
Common stocks		8,359,165	
Other long-term investments		794,285	
Total current assets			15,570,237
Property and Equipment--Net:			
Land, building, and improvements		21,383,589	
Furniture and equipment		5,419,267	
Leasehold improvements		213,135	
Other property and equipment		86,120	
Total property and equipment			27,102,111
Total Assets			$65,192,229

Family Health Plan Cooperative
Liabilities and Net Worth
As of December 31, 1997

Current Liabilities:			
Accounts payable		$ 316,135	
Claims payable (reported and unreported)		16,103,217	
Unearned premiums		13,545,020	
Amounts due to affiliates		1,863,741	
Aggregate write-ins for other current liabilities			
(1) Current portion of lease obligation		32,527	
Total current liabilities			$31,860,640
Other Liabilities:			
Loans and notes payable		3,000,000	
Aggregate write-ins for other liabilities			
(1) Deferred liab. – Malpractice	2,633,098		
(2) Noncurrent portion of lease oblig.	94,643	2,727,741	
Total other liabilities			5,727,741
Total Liabilities			37,588,381
Net Worth:			
Contributed capital		29,658	
Retained earnings/fund balance		27,574,190	
Total net worth			27,603,848
Total Liabilities and Net Worth			$65,192,229

Family Health Plan Cooperative
Statement of Revenue and Expenses
For the Year 1997

Revenues			
Premium		$ 171,987,699	
Fee-for-service		156,892	
Title XIX-Medicaid		2,891,586	
Investment		1,529,015	
Aggregate write-ins for other health care related revenue			
(1) Misc. Other Health Income	74,786		
(2) Loss on Disposal of Assets	(28,059)		
(3) Self-funded Reimbursement	(10,882)	35,845	
Aggregate write-ins for other revenue – Misc. Income		6,800	
Total revenue			$ 176,607,837
Medical and Hospital Expenses			
Physician services		55,937,070	
Other professional services		25,255,740	
Outside referrals		28,202,023	
Emergency room, out-of-area		10,438,113	
Occupancy, depreciation, and amortization		4,520,132	
Inpatient		49,788,117	
Aggregate write-ins for other medical expenses			
(1) Lab & X-ray Exp.	1,855,164		
(2) Pharmaceutical Drugs	19,388,915		
(3) Other In-house Med. Exp.	5,629,439	26,873,518	
Subtotal		201,014,713	
Less:			
Reinsurance expenses net of recoveries		595,922	
Copayments		1,298,063	
COB and subrogation		38,363,664	
Subtotal		40,257,649	
Total medical and hospital			160,757,064
Administrative Expenses			
Compensation		16,488,744	
Interest expense		210,573	
Occupancy, depreciation, and amortization		360,059	
Marketing		1,067,201	
Aggregate write-ins for other administration expenses			
(1) Board compensation & audit fees	279,684		
(2) Data processing	225,101		
(3) General Admin.	1,489,321	1,994,106	
Total administrative expenses			20,120,683
Total expenses			180,877,747
Net Income/(Loss)			$ (4,269,910)

Family Health Plan Cooperative
Statement of Net Worth
As of December 31, 1997

Net worth, beginning of year	$32,369,016
Increase (decrease) in contributed capital	(521,354)
Increase (decrease) in retained earnings/fund balance:	
(a) Net income (loss)	(4,269,910)
(b) Decrease (increase) in nonadmitted assets	(1,583,105)
(c) Aggregate write-ins for changes in retained earnings	1,609,201
Net worth, end of year	$27,603,848

Family Health Plan Cooperative
Statement of Cash Flows (Indirect Method)
As of December 31, 1997

Cash Flows From Operating Activities		
Net Income/(Loss)		$(4,269,910)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities		
Depreciation and Amortization		2,344,011
Change in Operating Assets and Liabilities		
(Increase)/Decrease in Operating Assets:		
Premium receivable		414,918
Health care receivable		(392,581)
Aggregate write-ins for (increase)/decrease in operating assets		(248,209)
Increase/(Decrease) in Operating Liabilities:		
Medical claims payable		(3,047,395)
Due to affiliates		1,863,741
Unearned premiums		(609,553)
Accounts payable		137,310
Accrued medical incentive pool		(184,838)
Aggregate write-ins for (increase)/decrease in operating liabilities		56,884
Net cash provided (used) from operating activities		(3,935,622)
Cash Flows From Investing Activities		
Receipts from restricted cash and other assets	4,741	
Receipts from investments	5,147,382	
Payments for property, plant & equipment	(1,116,542)	
Aggregate write-ins for investing activities	(638,213)	
Net cash provided by investing activities		3,397,368
Cash Flows From Financing Activities		
Loan proceeds from non-affiliates	1,000,000	
Principal payments on loans from non-affiliates	(1,000,000)	
Principal payments under lease obligations	(26,360)	
Net cash provided by investing activities		(26,360)
Net Increase (Decrease) in Cash and Cash Equivalents		(564,614)
Cash and Cash Equivalents at Beginning of Year		1,504,935
Cash and Cash Equivalents at End of Year		$ 940,321

Growth of Family Health Plan Cooperative

Year	Assets	Liabilities	Net Worth	Premium & Related Revenue	Medical & Hospital Expenses	Net Income/ (Loss)
1997	$65,192,229	$37,588,381	$27,603,848	$175,072,022	$160,757,064	$(4,269,910)
1996	71,767,608	39,398,592	32,369,016	174,277,298	159,857,207	(3,513,128)
1995	72,812,306	37,013,300	35,799,006	176,466,173	157,232,744	1,159,869
1994	70,599,783	35,960,647	34,639,136	165,177,196	144,793,604	4,983,718

Enrollment and Utilization

Year	Enrollment	Hospital Days/1,000	Average Length of Stay
1997	101,126	395.28	4.52
1996	103,117	374.86	4.52
1995	106,081	395.66	4.51
1994	107,226	417.49	4.88

Per Member Per Month Information

	1997	1996	Percentage Change
Revenues:			
Premiums	$142.78	$139.76	2.2%
Supplemental	4.37	3.69	18.5
Medicare/HCFA	28.34	23.54	20.4
Fee-for-service	0.33	0.00	---
Other	0.81	2.64	(69.4)
Total Revenues	$176.63	$169.63	4.1%
Expenses:			
Clinical	51.52	52.90	(2.6)
Pharmacy	15.86	14.74	7.6
Hospitalization	41.28	37.43	10.3
Referral – Professional.	25.36	21.57	17.6
Referral – Non-physician	24.69	21.80	13.3
Emergency	8.57	7.45	15.1
Total Medical	167.28	155.89	7.3
Administrative Expense	16.29	16.93	(3.8)
Total Expenses	$183.57	$172.81	6.2%

Enrollment has declined each year since 1995. Since the last examination, net worth as reported in the cooperative's annual statements has declined 20%. 1997 marked the second year of net losses, as premiums have failed to cover expenses. The losses have put a strain on the cooperative's cash flow. Subsequent to year-end 1997, the cooperative negotiated two $6 million lines of credit, one with Group Health Cooperative of South Central Wisconsin and one with Family Health Systems. As of the date of this examination, the cooperative had drawn $9 million. Management believes that this source of cash will be sufficient to maintain operations until the trend of negative cash flow is reversed; however, they are investigating other sources of cash in case of unexpected catastrophic claims. The cooperative's management is aware of problems and is having an actuarial review performed of its underwriting and rating procedures. In addition, management has developed a plan which it believes addresses turning around its negative trends.

Reconciliation of Net Worth per Examination

The following schedule is a reconciliation of net worth between that reported by the cooperative and as determined by this examination:

	Increase	Decrease	
Net worth December 31, 1997, per annual statement			$27,603,848
Examination Adjustments:			
Claims Payable	$	$(3,992,282)	
Unearned Premium		(690,000)	
Net increase or (decrease)	$ 0	$(4,682,282)	(4,682,282)
Net worth December 31, 1997, per examination			$22,921,566

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 23 specific comments and recommendations in the previous examination report, of which 20 pertained to market regulation issues. The current examination did not include a compliance review for the market regulation recommendations. The three financial comments and recommendations contained in the last examination report and actions taken by the cooperative are as follows:

1. Conflict of Interest—It is recommended that the cooperative implement a procedure to ensure that all directors complete and return a conflict of interest questionnaire to the cooperative on an annual basis as required by a directive of the Commissioner of Insurance.

   Action—Compliance.

2. Bylaws—It is recommended that the cooperative's board of directors include the number of directors specified in the bylaws or amend the bylaws to be consistent with the practices of the cooperative.

   Action—Compliance.

3. Cash and Cash Equivalents—It is recommended that the cooperative establish such procedures as are necessary to bring the cooperative's treatment of unclaimed funds greater than $50 into compliance with s. 185.03 (10), Wis. Stat.

   Action—Noncompliance, see comments in the summary of current examination results.

Summary of Current Examination Results

Bonds

In the 1997 annual statement, bonds were reported at market value. Per the *Special Health Maintenance Organization Annual Statement Blank Instructions for the State of Wisconsin*, bonds are to be reported at the amortized book value. Since the dollar value difference is not deemed material, an examination adjustment is not being made. It is recommended that the cooperative report bonds at amortized book value in future statutory financial statements, as required by the *Special Health Maintenance Organization Annual Statement Blank Instructions for the State of Wisconsin.*

Cash and Cash Equivalents

As stated in s. 177.015, Wis. Stat., unclaimed funds may be forfeited to the cooperative instead of the State Treasurer. However, s. 185.03 (10), Wis. Stat., requires certain conditions to be met if the cooperative chooses to forfeit the funds to the cooperative. If the cooperative chooses this option, the following conditions must be met:

(a) No earlier than 3 years and no later than 5 years after the funds are first made available to their owners, the board declares the funds forfeited to the cooperative unless claimed by the date specified under par. (b).

(b) After the declaration under par. (a), the cooperative gives notice that states that the funds shall be forfeited if not claimed by a specified date.

(c) The date specified in the notice under par. (b) is a business day at least 60 days after the date of mailing of the notice.

(d) The notice under par. (b) is mailed to the last-known address of each owner and is published as a class 1 notice under ch. 985 on or before the date of mailing in a newspaper published in the municipality containing the service area of the cooperative.

(e) The cooperative dedicates any funds remaining unclaimed after the date specified in par. (b) to educational purposes, limited to providing scholarships or loans to students, or to charitable purposes, as the board determines, within one year after the date the funds are declared forfeited under par. (a). In this paragraph, educational purposes does not include political purposes as defined in s. 11.01 (16).

As was also noted at the previous examination, Family Health Plan has been writing these forfeited funds back into cash as operating income without following the above procedures. It is again recommended that the cooperative establish such procedures as are necessary to bring the cooperative's treatment of unclaimed funds greater than $50 into compliance with s. 185.03 (10), Wis. Stat.

Premiums

Concerning premiums receivable, the cooperative does not have an account established to write off bad debts and does not have a systematic approach for collection of debt. Amounts are written off periodically when collection attempts have failed. It is recommended that the cooperative develop formal procedures for collections and establishing an allowance account for uncollectible premiums receivable.

In their year-end audit, the cooperative's CPAs made an adjustment increasing the unearned premium reserve by $690,000. Exam review indicated the adjustment pertained to a group whose unearned premium balance was incorrectly calculated on the cooperative's system. The adjustment is accepted for purposes of this examination report.

Agents Commissions

Examination review of the annual statement supplement schedule, Agents Commissions on Wisconsin Business, indicated that the number of agents and commission rate were inaccurately reported. It is recommended that the cooperative properly report agent data in future annual statement supplement schedules.

Claims Payable

The CPAs' audit of the cooperative's December 31, 1997, financial statements resulted in an adjustment increasing claims payable by $3,992,282. This adjustment has been accepted for purposes of the examination. A lag factor analysis of the cooperative's IBNR reserves, using the CPA-adjusted number, resulted in a slightly redundant development.

In the course of examining the cooperative's claims payable balances, requests were made for information to reconcile data per its payables report and processed claims report to data per the general ledger detail. The company was unable to provide such reconciliations, but indicated other procedures that it follows to provide some comfort with the quality of the data. As the cooperative is aware of problems in this area and is in the process of implementing a new accounting system by July 1999, which it expects to correct these deficiencies, a recommendation is not being proposed at this time.

Information Technology (IT)

As part of the examination process, a review was made of the cooperative's IT environment and controls. IT services are provided to FHPC by FHS under a management services agreement, as outlined in the section of this report captioned "Management and Control."

Concerning the physical security of its IT equipment, the company indicated that its mini-computers (AS400s) are maintained in locked rooms. Examiner review of one site indicated that while the AS400, itself, was in a locked computer room, logical security was not maintained as terminals for the AS400 were located outside the room. While the terminals are generally to be monitored by operators, they are not secure, as such.

Procedures for backing up the cooperative's data include a nightly incremental back-up and a weekly system save. Master tapes are created as of year-end. The tapes are stored in a locked fireproof container, not off-site.

It is recommended that the cooperative take actions to improve controls over its IT system. These actions should address the following concerns:

(a) Improve controls over access to AS400 terminals;
(b) Develop a procedure for regularly moving back-up copies of its data to off-site storage.

Examination review indicated that the company does not currently have a disaster recovery plan, as pertains to its IT system. The company feels that its disaster recovery plan is in the fact that it has a number of interconnected AS400s where processing could be transferred in the event of a disaster, but does not have a formal plan outlining this. It is recommended that the cooperative require the development of a formal, written disaster recovery plan that more fully addresses the whole company. As the company considers centralizing its information systems, this plan will need to be rethought.

Compulsory Surplus Requirement

As noted in the section of this report captioned "Financial Requirements," HMOs are required to maintain minimum compulsory surplus. The cooperative's calculation as of December 31, 1997, as modified for examination adjustments is as follows:

Assets	$ 65,192,229	
Less:		
Special deposit	1,762,899	
Liabilities	37,588,381	
Examination adjustments	4,682,282	
Total		$21,158,667
Net premium earned	174,879,285	
Compulsory factor	3%	
Compulsory surplus		5,246,379
Compulsory Excess		$15,912,288

Although the cooperative has had negative financial trends, it continues to exceed the minimum surplus requirements of s. 609.97, Wis. Stat. Prior to the recent trends, the cooperative was profitable and accumulated surplus. This accumulation has provided a cushion to absorb losses from a net worth standpoint, but does not assist with the issue of cash flow concerns.

IX. CONCLUSION

Family Health Plan Cooperative is a nonprofit, staff model health maintenance organization insurer, serving the greater Milwaukee area. It is part of an affiliated group that includes Family Health Systems and Group Health Cooperative of South Central Wisconsin.

Since the last examination, as of December 31, 1994, the cooperative has experienced a decline in assets and net worth, as well as a 6% decrease in membership. The level of net worth has declined 33.5% from $34,639,136 at year-end 1994 to $22,921,566 per this examination report. The company has experienced net losses in the past two years, which have put a strain on the cooperative's cash flow. As noted in this report, the cooperative negotiated two $6 million lines of credit, one with Group Health Cooperative of South Central Wisconsin and one with Family Health Systems, which management believes will be a sufficient source of cash to maintain operations until the trend of negative cash flow is reversed. Additionally, the cooperative's management is having an actuarial review performed of its underwriting and rating procedures. FHPC management, with the active participation of the board, has developed a plan to address its negative trends.

As summarized in the next section, the examination of Family Health Plan Cooperative resulted in one comment and six recommendations, one of which was a repeat recommendation. Two adjustments were made as a result of the examination, reducing net worth by $4.7 million.

X. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 28 - Bonds — It is recommended that the cooperative report bonds at amortized book value in future statutory financial statements, as required by the *Special Health Maintenance Organization Annual Statement Blank Instructions for the State of Wisconsin.*

2. Page 28 - Cash and Cash Equivalents — It is again recommended that the cooperative establish such procedures as are necessary to bring the cooperative's treatment of unclaimed funds greater than $50 into compliance with s. 185.03 (10), Wis. Stat.

3. Page 29 - Premiums Receivable — It is recommended that the cooperative develop formal procedures for collections and establishing an allowance account for uncollectible premiums receivable.

4. Page 29 - Agents Commissions — It is recommended that the cooperative properly report agent data in future annual statement supplement schedules.

5. Page 29 - Claims Payable — In the course of examining the cooperative's claims payable balances, requests were made for information to reconcile data per its payables report and processed claims report to data per the general ledger detail. The company was unable to provide such reconciliations, but indicated other procedures that it follows to provide some comfort with the quality of the data. As the cooperative is aware of problems in this area and is in the process of implementing a new accounting system by July 1999, which it expects to correct these deficiencies, a recommendation is not being proposed at this time.

6. Page 30 - Information Technology — It is recommended that the cooperative take actions to improve controls over its IT system. These actions should address the following concerns:

   (a) Improve controls over access to AS400 terminals;
   (b) Develop a procedure for regularly moving back-up copies of its data to off-site storage.

7. Page 30 - Information Technology — It is recommended that the cooperative require the development of a formal, written disaster recovery plan that more fully addresses the whole company.

XI. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employes of the cooperative is acknowledged.

In addition to the undersigned, the following representative(s) of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Teri McClintock	Insurance Examiner
Randy Milquet	Insurance Examiner—Advanced

Respectfully submitted,

Amy M. Johnson
Examiner-in-Charge

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